



STATE OF ALABAMA
ALABAMA PUBLIC SERVICE COMMISSION
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MONTGOMERY, ALABAMA 36130-4260

JIM SULLIVAN, PRESIDENT

JAN COOK, ASSOCIATE COMMISSIONER

GEORGE C. WALLACE, JR., ASSOCIATE COMMISSIONER

WALTER L. THOMAS, JR.

SECRETARY

ALABAMA POWER COMPANY,

Petitioner

PETITION: To amend Rate CNP (Certified New Plant) to provide for the recovery of costs incurred to comply with environmental mandates.

DOCKET NOS. 18117 and 18416

ORDER

BY THE COMMISSION:

I. Introduction and Background

On August 2, 2004, Alabama Power Company ("Alabama Power"), acting pursuant to the provisions of *Alabama Code* §§ 37-1-80 and 37-1-81 (1992), filed with this Commission a revised Rate CNP (Certificated New Plant). The purpose of the revision is to provide Alabama Power with an appropriate mechanism for the timely recovery of expenditures that are made in order to comply with environmental laws, regulations and other mandates. Alabama Power proposed that the revised rate be effective on September 1, 2004 and first applicable to customer billings beginning in January, 2005.

In full compliance with the provisions of Alabama Code § 37-1-86(a), the Commission issued a Procedural Schedule on August 4, 2004, setting forth dates and requirements related to intervention, testimony, public hearing, and other matters concerning Alabama Power's August 2, 2004 filing. ("Scheduling Notice"). Said

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Scheduling Notice was served on some 267 individuals, corporations and/or entities including 14 newspapers and/or radio stations throughout Alabama. A subsequent Commission Order dated August 18, 2004 suspended the effective date of the proposed rate through November 30, 2004 to accommodate the hearing schedule and enable the Commission to consider the evidentiary record and issue an appropriate order with respect to the filing.

In accordance with the Scheduling Notice, a timely motion to intervene was submitted by the Office of the Attorney General ("Attorney General"), acting pursuant to *Alabama Code* § 37-1-16. According to the Attorney General's notice, the primary issue in the proceeding is "whether it is appropriate to recover environmental costs through an amendment to Rate CNP or to use Rate RSE for recovery of any costs related to environmental laws and regulations." The Attorney General's secondary inquiry concerned the proposed methodology for allocating the mandated environmental costs among the various customer classes.

In addition to the Attorney General, a timely intervention was filed by a number of separately-named industrial customers of Alabama Power collectively identified as the Alabama Industrial Energy Consumers ("AIEC"). These industrial customers expressed general support for Alabama Power's proposal, and specifically stated that their intervention was "not for the purpose of seeking affirmative relief." No other interventions or comments were received with respect to Alabama Power's August 2, 2004 filing.

Alabama Power filed its direct testimony on August 23, 2004 and served copies on all intervenors. Neither the Attorney General nor AIEC filed any responsive direct testimony, thus negating the need for rebuttal testimony by Alabama Power. As described more fully below, three witnesses appeared for Alabama Power at the public hearing that was convened on September 28, 2004. The direct testimony and accompanying exhibits of these witnesses were received into evidence without objection, and all three were available for cross-examination by the intervenors. Staff from the Commission's Energy Division also participated in the proceeding.¹ Given the absence of opposing testimony, all parties agreed on the record at the close of the September 28 hearing that there was no need for post-hearing briefs, which under the Scheduling Notice were otherwise due on October 18, 2004. (Tr. 106-107) The record was thus closed and nothing further was required to render the matter ripe for decision.

II. The Evidentiary Hearing

While overlapping to some degree, Alabama Power's evidentiary presentation was generally divided into three areas relevant to its filing: the reasons for the proposed cost recovery mechanism and the "mechanics" of its operation; the principal sources of current environmental mandates; and the process whereby compliance strategies are developed and implemented.

The first of these areas was addressed by Mr. Art P. Beattie, who is Alabama Power's Vice President and Comptroller. Mr. Beattie explained why a specific rate

¹ The Commission staff participated in the hearing in a manner consistent with the Supreme Court's decision in *Continental Telephone Company of the South v. APSC*, 479 So. 2d 1195, 1199-1200 (Ala. 1985) concerning the role of the staff in such Commission proceedings.

mechanism was needed for the recovery of environmental compliance costs (as opposed to reliance on existing rate mechanisms), and also why the new mechanism was properly added to Rate CNP. Specifically, he testified that since 1982 Rate RSE has been the principal mechanism for recovering Alabama Power's costs associated with the provision of retail electric service, which to this point have included its costs associated with environmental compliance activities. (Tr. 17). Because additional environmental mandates are accelerating the timing and level of these types of expenditures, however, Alabama Power is now proposing this specific mechanism to recover such environmental compliance costs. Mr. Beattie testified that continued reliance on Rate RSE to handle these growing costs could trigger destabilizing operations of that rate and would cause an unacceptable lag in their recovery. (Tr. 18). Recovering environmental compliance costs pursuant to a mechanism designed for this specific purpose would avoid these problems, and would also have the added advantage of identifying those costs that are, by definition, attributable to governmental mandates and not the decisions of Alabama Power or this Commission.

Mr. Beattie explained that the proposed recovery mechanism was included in Rate CNP because of its traditional role in handling costs that are beyond the "purpose and capability" of Rate RSE. (Tr. 17-18). Referencing illustrative examples of the underlying calculations, Mr. Beattie explained in detail how the proposed recovery mechanism would operate. (Tr. 19-23, Alabama Power Exhibits 2 and 3).

During cross-examination by the Attorney General, Mr. Beattie elaborated on the appropriateness of the proposed methodology for allocating environmental compliance

costs to customers under the new Subpart C of Rate CNP, explaining that it would be done in the same manner as revenue adjustments under Rate RSE. Although not the only possible allocation methodology, this was considered to be the best approach because the mechanism – like Rate RSE – would recover both capital and O&M costs. (Tr. 31-32). Moreover, the proposed approach would further this Commission's traditional policy of supporting economic development in the state while moving towards rate parity among customer classes. (Tr. 33-36).

The Attorney General also questioned Mr. Beattie about the scope of the annual informal meeting to review the Environmental Compliance Plan to be filed by Alabama Power. Mr. Beattie responded that the intent of the meeting was not to debate what the environmental standards should or should not be, but to discuss what the standards are, how Alabama Power will comply with those standards and all issues associated with the cost of compliance. Mr. Beattie also agreed that a discussion of alternative ways of meeting the standards and their costs would certainly be appropriate topics for the informal meeting. (Tr. 38-44)

Following the Attorney General's cross-examination of Mr. Beattie, Mr. John Free, Supervisor of the Commission staff's Electricity Section, asked a clarifying question² regarding the treatment of O&M costs associated with environmental compliance facilities that are already in service. (Tr. 50-51). In response, Mr. Beattie confirmed that, while the capital costs of such facilities will not be recovered through Subpart C of Rate CNP (and will continue to be recovered through Rate RSE),

subsequent O&M expense (in 2005 and beyond) associated with such already in-service facilities will be recovered under Subpart C of Rate CNP.³ (Tr. 51).

The second witness was Mr. Willard L. Bowers, Vice President of Environmental Affairs for Alabama Power, who provided a general overview of the environmental laws and regulations with which Alabama Power must comply. Mr. Bowers testified that the most significant mandates in terms of their impact on Alabama Power's operations are the Clean Air Act, the Clean Water Act, and the Resource Conservation and Recovery Act. (Tr. 61-64). Mr. Bowers reviewed Alabama Power's history of compliance with these environmental mandates. (Tr. 65-68). He also discussed ongoing and pending changes to environmental laws and regulations and steps that Alabama Power has already taken to address those evolving requirements. (Tr. 69-73).

During cross-examination, the Attorney General questioned Mr. Bowers on the process used by the Alabama Department of Environmental Management ("ADEM") in reviewing Alabama Power's selection of environmental compliance technologies. (Tr. 74-75). In response, Mr. Bowers referenced the Jefferson County 1-hour ozone requirement to demonstrate how Alabama Power must, in obtaining permits from ADEM for compliance facilities, prove to ADEM's satisfaction that Alabama Power's compliance strategy will be effective in achieving the emissions reductions that are required. (Tr. 74-76).

² See Footnote 1.

³ In a similar vein, we would note that, under the existing provisions of Rate CNP, environmental facilities that are placed in service in conjunction with the commercial operation date of a newly certificated generating facility would be handled (as before) under Subpart A of the rate.

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Alabama Power's third witness was Mr. John C. Huggins. Mr. Huggins is currently the Scrubber Program General Manager (Engineering and Construction Services) for Southern Company Services, Inc. ("SCS"), and he also has extensive experience in connection with compliance programs related to NO_x and other regulations. Mr. Huggins explained the process whereby SCS, working in conjunction with Alabama Power personnel and subject to the approval of Alabama Power management, develops and implements a comprehensive and effective environmental strategy that enables Alabama Power to comply with governing legal requirements in an efficient and economical manner. Specifically, Mr. Huggins testified regarding the major technologies that are available to remove pollutants under the most significant environmental mandates. (Tr. 88-89). He then reviewed the process used for coordinating compliance strategies and establishing schedules to meet requirements. (Tr. 89-92). Finally, Mr. Huggins explained the process for implementing the compliance plan and working with technology vendors and contractors. (Tr. 93-96).

During cross-examination, the Attorney General questioned Mr. Huggins regarding Alabama Power's environmental compliance planning in the context of compliance planning for the rest of the Southern Company system. In particular, the Attorney General inquired as to the manner in which Alabama Power's portion of the plan is determined. (Tr. 98). Mr. Huggins explained that Alabama Power has standards that it must meet (as do other subsidiaries of Southern Company) and that SCS develops plans for resources and schedules that comply with those company-specific constraints and deadlines. In short, Mr. Huggins made clear that the role of SCS is not

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to decide which of the Southern Company subsidiaries will take action to address environmental mandates, but rather to coordinate the development and implementation of plans to meet the separate mandates applicable to the respective companies. (Tr. 98-99).

Mr. Huggins further explained how timely decision making and prudent planning are essential to the ultimate success of SCS's compliance plans. (Tr. 99-101). Mr. Huggins pointed out that Alabama Power, as a subsidiary of Southern Company, is able to obtain economies of scale and to command attention and savings from technology suppliers and vendors as it implements its compliance strategy. (Tr. 102-103). These aspects of the coordinated "system approach" are directly beneficial to retail customers because they help ensure Alabama Power's timely compliance at a cost that is lower than if it had acted alone.

III. Staff Review of Proposed Revisions to Rate CNP

Guided first and foremost by the provisions of *Alabama Code* §37-1-80, the Commission's staff has engaged in an extensive review of Alabama Power's filing, the reasons for it, and the manner in which the proposed recovery mechanism will operate. In addition to the evidentiary record compiled in this cause, the staff also considered Alabama Power's responses to a number of data requests seeking clarification and additional explanation concerning certain aspects of the rate under review. The staff's assessment was also bolstered by the analysis of the measures other affected state commissions have implemented to address the recovery of environmental compliance costs resulting from the federal mandates at issue in this proceeding.

The Commission staff's investigation of Alabama Power's proposed revisions to Rate CNP also included an assessment of potential recovery mechanisms other than the proposed revisions to Rate CNP. Namely, the staff considered utilization of the current RSE mechanism, modifications to the current RSE mechanism and the establishment of a separate environmental factor. For reasons consistent with the arguments set forth below, however, the staff ultimately concluded that the revisions to Rate CNP proposed by Alabama Power represent the most appropriate mechanism for recovering the environmental compliance costs that will be incurred by the company as a result of the federal mandates addressed herein. As described in more detail below, however, the staff recommended that certain clarifications be made prior to the adoption of Alabama Power's August 2, 2004 filing.

IV. Discussion

A. Governing Legal Requirements

In considering Alabama Power's filing, we are mindful of two fundamental legal principles that together establish parameters within which the Commission must operate. The first of these relates to the nature of the costs at hand, which by definition are the product of governmental mandates establishing environmental requirements with which Alabama Power, by law, must comply. These are not costs that Alabama Power can simply choose not to incur, which in turn strongly supports a presumption that they are prudent expenditures. It is true, of course, that questions concerning the particular compliance plans could arise, but by any measure these are significant costs over which Alabama Power has little or no control in terms of their timing or their relative

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magnitude.⁴ Moreover, there is absolutely no dispute that the costs related to these environmental mandates are directly associated with the provision of retail electric service. In other words, Alabama Power must incur these costs in order to keep its facilities and operations in compliance with state and federal law, and thereby continue to use them to supply service to retail customers.

A second legal consideration directly related to the filing entails one of the most basic principles of regulation. A utility is entitled to recover the costs it prudently incurs in connection with the service it provides to the public. This principle underlies our enabling statutes and permeates innumerable decisions of this Commission and of the Alabama Supreme Court. So long as a cost is prudent, the Commission is bound by law to establish rates that will permit its recovery.

Taken together, these two legal considerations are central to our assessment of Alabama Power's filing. The environmental costs at issue are the direct result of governmental mandates, and hence are an unavoidable cost associated with the provision of retail electric service. That fact leads to the application of the second principle regarding Alabama Power's right to recover costs of this nature. When viewed in this light, the question is not whether environmental compliance costs are recoverable from retail customers, but rather whether the proposed revisions to Rate CNP represent a reasonable ratemaking mechanism by which to provide for such recovery.

⁴ Under Alabama law, costs to be borne by ratepayers must be the product of "honest, efficient and economical management." See *Alabama Code* § 37-1-80(a). In this regard, however, the Supreme Court of Alabama has cautioned that the role of the Commission is to regulate, and not to act as management or to usurp the traditional prerogatives of management. *Alabama Power Co. v. APSC*, 359 So. 2d 776, 780 (Ala. 1978). In any event, no party to this proceeding has taken issue with any aspect of Alabama Power's compliance plans, which will be outlined in more detail in the annual filings contemplated under the recovery mechanism established hereunder.

B. Background on Rate CNP

Rate CNP was first established by the Commission in 1982 in conjunction with Rate RSE (Rate Stabilization and Equalization). Rate RSE reflects a broad consideration of Alabama Power's overall cost of service, and provides an opportunity for periodic upward or downward adjustments in response to normal fluctuations in revenues and expenses. Because of the various restrictions and limitations incorporated in this mechanism, however, it is not well suited to address larger cost impacts that are less routine in nature. One such impact is the financial effect of placing a new generating plant into commercial operation. Rate CNP was originally designed to address this problem, and it does so by adjusting retail rates to recover the additional capital costs associated with new facilities. In 2000, the Commission approved an amendment to Rate CNP to authorize Alabama Power to recover the fixed costs associated with power purchase arrangements that were likewise difficult to recover in a timely manner through existing rate mechanisms. In the present filing, Alabama Power is proposing a further revision to Rate CNP, in this case to provide an appropriate mechanism for the recovery of environmental compliance costs.

Since the original adoption of Rate CNP, the government has, through various legislative and regulatory initiatives, adopted numerous environmental goals that have resulted in the imposition of increasingly costly requirements on electric utilities. (Tr. 61-64). As a consequence of these (and other) environmental laws, regulations and other mandates, Alabama Power has spent approximately \$500 million over the last two decades, and the level of such expenditures is expected to increase as additional

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requirements take effect. In the past, these types of costs have been among those recognized under Rate RSE. As explained above, however, Rate RSE is designed to handle more routine fluctuations in revenues and expenses, as opposed to larger cost impacts that Alabama Power has little ability to control. This latter category now includes the costs associated with environmental compliance activities.

C. Proposed Revisions to Rate CNP

It is clear from the undisputed evidence that the acceleration and scale of environmental compliance costs have reached a point where they require a rate mechanism that is better suited than Rate RSE to recover them in a reasonable and timely manner. Consistent with its purpose and function in relation to Rate RSE, Rate CNP is a logical vehicle for this mechanism. The additional capital costs and expenses are necessary in order to keep Alabama Power's existing electric facilities and operations in compliance with governing legal requirements, and thereby continue to provide reliable service to its customers. Moreover, we are aware that the establishment of a specific mechanism for the timely recovery of these expenditures could have a favorable effect on Alabama Power's credit rating, which in turn may benefit customers by producing a lower cost of financing.⁵ We also believe that creating a discrete mechanism for this purpose will enable the Commission, other policymakers, and interested parties to more easily identify, monitor and understand the costs associated with Alabama Power's mandated environmental compliance activities.

⁵ See, Dow Jones Newswire, *Fitch Ratings Places Alabama Power on Rating Watch Positive* (August 10, 2004) (available at <http://online.wsj.com/article/0,,BT_CO_20040810_005306,00.html>). [Discussing Fitch Credit Ratings Agency's positive view of Alabama Power's filing of the proposal to revise Rate CNP].

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Revised Rate CNP provides that, by December 1 of each year (beginning December 1, 2004), Alabama Power will submit to the Commission an environmental factor for each retail rate schedule that will be applied to each kilowatt-hour thereunder during the next calendar year. The procedure for deriving these environmental factors is set forth in new Subpart C of Rate CNP. First, the estimated costs of environmental compliance activities are projected for the upcoming twelve-month period from January 1 to December 31. That amount is then separated to retail electric service and combined with any over-recovery or under-recovery balance (reflecting a "true-up" of prior projections with available actual cost data) to determine the additional retail revenue requirement. This revenue requirement is allocated to each retail rate schedule based on the rate schedule's proportion of the total base rate retail revenue, as calculated for the twelve-month period ending September 30. In order to determine the appropriate factor for each rate schedule, its allocated share of the additional retail revenue requirement is divided by the estimated retail kilowatt-hour sales under that rate schedule for the upcoming twelve-month period from January 1 to December 31. The resulting amount is the factor that will be applied to each kilowatt-hour sold under the applicable retail rate schedule during the next calendar year.

In conjunction with the above-described process, revised Rate CNP provides for an annual informal meeting where the Commission, the staff, and any other interested party can discuss Alabama Power's environmental compliance activities. This meeting is to be held on the second Tuesday in December (beginning December 14, 2004), and will be noticed by the Commission just as other proceedings. The meeting will be

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similar in purpose and concept to the informal meetings that have long been held in connection with submittals under Rate RSE. More specifically, Alabama Power will utilize the informal meetings to provide an overview of its environmental compliance plan for the next five (5) years, together with the estimated cost associated with its implementation.⁶ Alabama Power will also provide an overview of pending environmental laws, regulations or other mandates relevant to its environmental compliance activities, along with any other matters deemed by the Commission to be informative and appropriate.

The overall purpose of this informal meeting is to facilitate dialogue and thereby promote a better understanding of Alabama Power's environmental compliance activities and of the costs attributable to environmental mandates. To this end, the Commission contemplates discussion regarding the noted topics. The Commission does not, however, intend for said meeting to serve as a forum for the debate of legal or policy matters beyond the jurisdiction of this Commission or matters beyond the scope of the environmental issues under consideration.

While in agreement with the substantive aspects of Alabama Power's filing, the staff offered several items for our consideration. The first of these pertains to the possibility of monetary fines or penalties attributable to defective or inadequate performance by environmental compliance facilities. Although the costs of these facilities would be recovered through the operation of revised Rate CNP, the staff

⁶ An overview of the previous year's environmental activities and the costs associated therewith shall also be presented by Alabama Power in the years beyond 2004.

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suggests that any associated fines or penalties should not be reflected in the rate calculation. Instead, Alabama Power should seek to recoup any such fines or penalties from the responsible vendor or contractor. The staff further recommends that damages recovered from a vendor or contractor in excess of any fines or penalties absorbed by Alabama Power be recognized in the calculation of the environmental factor under Rate CNP. In this way, those damages (in excess of the fines or penalties) will help to offset the related costs that are being recovered through the operation of the rate.

The staff's second suggestion relates to the Commission's understanding and expectation of how the factors established under this new Subpart C of Rate CNP will be incorporated in Alabama Power's base rates from year to year. In this regard, the Commission expects that Alabama Power will follow the same practice it has used for many years in connection with factors under Rate RSE and existing Rate CNP. With specific reference to this proposed revision, the Commission intends that, following the annual filing of the factors developed in accordance with Subpart C of Rate CNP, the staff will have an opportunity to review and confirm these calculations. Once such staff review has taken place, Alabama Power will submit revised schedules for base rates incorporating the new factor for the upcoming year. Beginning with the second environmental cost year (i.e., the filing applicable to customer billings for 2006), Alabama Power will need to modify its base rates to both reflect the new factor and the elimination of the factor in place during the then-current environmental cost year.

The staff also recommends a modification to the filing related to the materials to be discussed at the informal meeting. (Alabama Power Exhibit 1, page 8). Under the

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proposed rate, Alabama Power contemplates providing an overview of its Environmental Compliance Plan (ECP) at the time of each annual meeting. The staff believes that the overview described in Item 3(c) should be developed in document form and filed with the Commission at least thirty (30) days prior to the December 1 deadline for the factor filing.⁷ In this latter regard, the staff acknowledges that the resulting timing differential between the submission of the ECP and the filing of the factors could result in some inconsistencies between the underlying estimates, but these differences (if any) should be minimal and, in any event, explainable.

The staff lastly recommends that Alabama Power be required to provide any reports deemed reasonably necessary and requested by the staff. The staff asserts that such future reporting requirements may become necessary to adequately monitor Alabama Power's environmental costs.

D. Moratorium during Initial Implementation

In considering Alabama Power's filing, the Commission recognizes that environmental compliance activities represent a legitimate and unavoidable cost associated with Alabama Power's provision of electric service. Revised Rate CNP is a reasonable mechanism for the recovery of those costs from retail customers, and is similar to approaches adopted in a number of other jurisdictions for this same purpose. At the same time, the Commission is mindful of its longstanding interest in rate stability for retail customers. Balancing all of these considerations, the Commission considers a

⁷ In years beyond 2004, said filing should include an assessment of the prior year's environmental activities and the costs associated therewith.

temporary moratorium on the operation of Rate RSE to be appropriate during the initial implementation of this aspect of Rate CNP. This moratorium (which requires the agreement of Alabama Power) would extend for a two-year period, and would prevent any upward (but not downward) adjustments under Rate RSE during calendar year 2005 or 2006.⁸ Rate RSE would thereafter operate in accordance with its terms to adjust retail revenues (upward or downward) beginning in calendar year 2007.

V. Findings and Conclusions

In view of the foregoing and after consideration of Alabama Power's filing, the evidentiary record, the recommendations of our staff and other information available to the Commission, the Commission FINDS that the proposed revisions to Rate CNP represent a just and reasonable mechanism for the timely recovery of environmental compliance costs incurred by Alabama Power in conjunction with the provision of jurisdictional electric service. In this regard, the Commission adopts and confirms the staff's recommendations described above concerning: (i) the handling of damages, fines and penalties associated with defective or inadequately performing environmental compliance facilities; (ii) the manner in which factors developed pursuant to Subpart C of Rate CNP are to be incorporated in base rate schedules; (iii) the development and filing of the ECP prior to the filing of the factors; and (iv) the requirement of future reports as deemed reasonably necessary and requested by the staff.

⁸The Commission is mindful that Alabama Power has depleted its storm reserve in repairing/restoring its system due to extensive damages resulting from Hurricane Ivan on September 16, 2004. The Commission accordingly finds that it would be appropriate for Alabama Power to explore means whereby the effects of Hurricane Ivan on the storm reserve can be replenished. Alabama Power shall not, however, increase its current retail electric rates during the moratorium period discussed herein in order to replenish its storm reserve.

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The Commission FURTHER FINDS that, as a stabilizing measure related to the initial operation of this aspect of Rate CNP, there should be a two-year moratorium on any upward (but not downward) adjustments under Rate RSE during calendar year 2005 or 2006. Rate RSE would thereafter operate in accordance with its terms for adjustments (if any) effective for March 2007 billings and thereafter.

IT IS, THEREFORE, ORDERED BY THE COMMISSION, that revised Rate CNP, subject to the conditions described in the body of this Order, is accepted and approved effective on and after November 1, 2004, and that the environmental factor developed pursuant to this revised Rate CNP will be first applied to customer billings for January, 2005 and thereafter in accordance with its terms.

IT IS FURTHER ORDERED BY THE COMMISSION, that Alabama Power is authorized to book such regulatory assets and/or regulatory liabilities on the balance sheet as are necessary or appropriate in order to implement the ratemaking procedures and process established hereunder.

IT IS FURTHER ORDERED BY THE COMMISSION, that Alabama Power shall, within five (5) business days of the date of this Order, provide written confirmation of its willingness to accept the two-year moratorium on the upward operation of Rate RSE (during calendar years 2005 and 2006) and the other conditions described herein.

IT IS FURTHER ORDERED BY THE COMMISSION, That Alabama Power shall, within five (5) business days of the date of this Order, file such revisions to Rate CNP as are necessary to conform to the staff's recommendation regarding the development and submission of the ECP, as described herein.

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DATED at Montgomery, Alabama, this 29th day of October, 2004.


ALABAMA PUBLIC SERVICE COMMISSION


Jim Sullivan, President


Jan Cook, Commissioner

George C. Wallace, Jr., Commissioner
votes no. (see Dissenting Opinion attached
hereto as Appendix A)

ATTEST: A True Copy


Walter L. Thomas, Jr., Secretary

APPENDIX A

STATE OF ALABAMA Alabama Public Service Commission

IN THE MATTER OF ALABAMA POWER COMPANY,

Petitioner

PETITION: To amend Rate CNP (Certified New Plant) to provide for the recovery of costs incurred to comply with environmental mandates.

Docket Nos. 18117 and 18416

Dissent By Commissioner George C. Wallace Jr.

It is my firm belief that all decisions of this Commission should be made with full consideration of the balance between the financial burden to Alabama consumer ratepayers and a fair and reasonable rate of return to the regulated utility. The majority decision of the Commission in this case shifts Alabama Power Company's entire burden of paying for environmental compliance to the consumers of Alabama. This will result in annual increases to Alabama consumers over the next nine years (2005-2013) in a process absent of any further evidentiary hearings by this Commission. For these reasons, and because I believe the majority decision has been made in a process that was procedurally flawed and was rushed through this Commission with no real notice to the people of Alabama, I must respectfully dissent.

I have requested of my fellow Commissioners that the motion and vote of the majority of the Commission on this matter be reconsidered at a special meeting

at which we consider a formula or methodology that looks at sharing the burden of environmental costs between Alabama Power Company and the consumers of Alabama. I have received no response to my request but was presented the proposed majority order on October 22, 2004.¹ My concerns about the decision of the majority of this Commission in Docket Nos. 18117 and 18416 thus remain unresolved and unaddressed.

My first concern is the flaw in our public notification process, which deprived the people of Alabama of real notice of the magnitude of this filing, and thus no reasonable opportunity to be heard about the rate increases they will face over the next nine years (2005-2013). I have learned that no press release was issued to the general public and news media in Alabama, which might notify the 1.3 million Alabama Power Company customers of this filing. The majority order states that the scheduling notice in this case “was served” on “some 267 individuals, corporations and/or entities including 14 newspapers and/or radio stations throughout Alabama”. (Majority order at p. 2). Any “notice” that occurred regarding this matter was insufficient in that it was apparently part of a mass “e-mail general mail out” by the Secretary of the Commission to those listed on an e-mail address list maintained in his office. This notice did not inform the general public of what was involved in this rate increase on Alabama Power Company customers over the next nine years.

¹ A copy of my request to my fellow Commissioners is attached hereto as Attachment A.

There is a second flaw in the purported public notice by this Commission. The Scheduling Notice that was e-mailed to the 267 e-mail addresses on file with the Secretary of the Commission provided for a final submission deadline of October 18, 2004 and specified that "Post Hearing Briefs in the form of Proposed Orders shall be submitted". This indicated to me, and likely to any members of the general public that received the Scheduling Notice, that this matter would not be considered and voted upon until the November 2004 Commission meeting. I believe that the majority's rush to judgment one week after the Administrative Hearing on September 28, 2004 does not serve the public interest. This Commission could have acted on this matter any time before November 30, 2004 without a further suspension of time by this Commission. This additional time would have allowed me, my fellow Commissioners, and Commission staff, who could not provide me answers to basic questions about this filing, additional time to analyze and consider reasonable alternatives that would balance the interests of Alabama ratepayers and Alabama Power Company.

I am also concerned about the exclusion of the Attorney General of Alabama and his representatives from meetings that occurred between Alabama Power Company representatives and this Commission about the merits of this rate filing. Under Alabama law, the Attorney General is charged with the responsibility of representing Alabama consumers in proceedings before this

Commission. See Ala. Code § 37-1-16.² Alabama law requires that the Attorney General “shall have the assistance and cooperation of the commission’s staff, when available, and access to the commission’s books, records, studies, and reports.” See Ala. Code §37-1-16(a). The Attorney General was not included in a multitude of meetings that occurred between Alabama Power Company representatives and this Commission, nor has the Attorney General been afforded the opportunity to have access to the studies and reports of the Commission on this important matter to Alabama consumers. A list of the meetings, which excluded the Attorney General, was provided to me on October 4, 2004 --the day before -- the Commission vote on this matter.³ This exclusion of the legal representative of the consumers of Alabama requires me to dissent in this matter.

There has been no analysis by this Commission or by Commission staff of the fundamental issue raised by the Office of the Attorney General in his motion to intervene – “whether it is appropriate to recover environmental costs through an amendment to Rate CNP or to use Rate RSE for recovery of any costs related to environmental laws and regulations. In other words, could these environmental improvement costs be recovered within the now existing Rate RSE Range of

² The Attorney General of Alabama did timely intervene in this docket, however, he has not indicated whether or not he supports or opposes the filing by Alabama Power Company in this docket. Alabama consumers, who the Attorney General represents under Alabama law, have therefore not had their position specified regarding the rate increases they will endure in the years 2005-2013.

³ A copy of the list of Commission meetings excluding the Attorney General is attached to this dissent as Attachment B.

13.0% to 14.5% without any further rate increases on the consumer?⁴ This Commission and its staff should thoroughly investigate this option for the recovery of these costs before shifting the entire burden to the consumers of this State, as the majority order of the Commission will do. On several occasions prior to the October 5, 2004 monthly meeting, I inquired of senior members of the PSC staff whether any analysis had occurred regarding the sharing of the burden of environmental costs among Alabama Power Company's ratepayers and the regulated utility through adjustments to Rate RSE. On each occasion, I was informed that no such analysis had occurred. The majority's conclusion that such analysis occurred is factually incorrect.⁵ In fact, at the October 5, 2004 monthly meeting of the Commission, I asked Energy Division senior staff whether any such analysis had occurred, and was informed that the only method for recovery of costs considered was the one requested by Alabama Power Company.

The majority order correctly recognizes that Alabama Power Company must comply with federal environmental mandates. I strongly support these clean air improvements that will benefit Alabama citizens. The majority order also correctly recognizes that a utility should be entitled to recover these environmental costs. The question before this Commission, however, is whether these costs could be recovered within the framework of the existing approved RSE range for

⁴ At the October 5, 2004 monthly meeting of the Alabama PSC, the Energy Division of the PSC forecast a return on average common equity of 14.17% for Alabama Power Company for the period ending December 31, 2004.

⁵ The majority order states "the staff considered utilization of the current RSE mechanism, modifications to the current RSE mechanism and the establishment of a separate environmental factor."

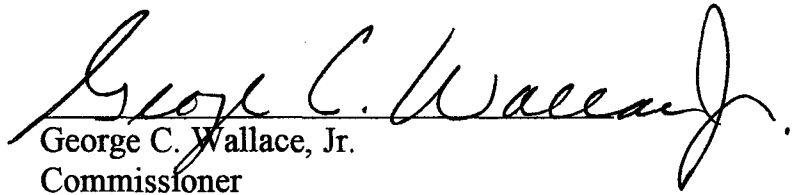
Alabama Power Company --which is 13.0% to 14.5%--with no additional cost to Alabama ratepayers. Alabama Power Company enjoys one of the most generous rates of return in the United States under Rate RSE. My own preliminary analysis indicates that the RSE range for Alabama Power Company could have absorbed much of these environmental costs, as has occurred for many years⁶, and Alabama consumers could have been spared the rate increases that are permitted by the majority order. By ordering these costs to be recovered under Rate CNP on an annual basis, without further formal evidentiary hearings in future years, the majority order has shifted the entire burden of these costs to the customers of Alabama Power Company, whose rates will increase in each of the next nine years.

Finally, I must address the so-called “*Moratorium during Initial Implementation*” described in pages 16-17 of the majority’s order. This is not a moratorium on rate increases on Alabama consumers, which I would support and which I would vote to impose. The “temporary moratorium on the operation of Rate RSE”, on upward adjustments under Rate RSE, for a two-year period during calendar years 2005 and 2006, described by the majority order, is an empty offer to Alabama consumers. The history of Rate RSE for Alabama Power Company over the past several years shows that upward adjustments by Alabama Power Company under Rate RSE are rarely necessary. Alabama Power Company enjoys

⁶ The majority order acknowledges that Alabama Power Company has spent and recovered approximately \$500 million over the past two decades on environmental mandates.

a generous rate of return under Rate RSE --a range of 13.0% to 14.5%-- one of the largest rate ranges in the United States. By shifting all of the recovery of environmental costs to consumers in Rate CNP, as the majority has done, the rate of return under Rate RSE will likely continue the historical pattern, making upward adjustments unnecessary. The majority's moratorium is a vacant offer to Alabama consumers. As Alabamians witness the increase in their power bills in each of the next nine years, the true picture of what has occurred in this regulatory docket will be felt by hardworking men and women, many in families that cannot afford it. This Commission, with this order, has failed the people of Alabama.

Dated at Montgomery, Alabama this 27TH day of October 2004.


George C. Wallace, Jr.
Commissioner

ATTACHMENT A



STATE OF ALABAMA

ALABAMA PUBLIC SERVICE COMMISSION

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GEORGE C. WALLACE, JR.
COMMISSIONER

BARBARA B. KELLEY
ASSISTANT FOR REGULATORY
RESEARCH AND ANALYSIS
ANNA C. BERRYHILL
EXECUTIVE ASSISTANT

MEMORANDUM

DATE: October 13, 2004

TO: President Jim Sullivan
Commissioner Jan Cook

FROM: George C. Wallace, Jr. *gcw*

SUBJECT: Reconsideration of Docket Numbers 18117-18416
Alabama Power Proposed Revision to Rate CNP

The purpose of this memorandum is to request that a special meeting be called by the Alabama Public Service Commission to reconsider the Commission's approval of the aforementioned Dockets. In the spirit of bringing about some sense of balance and fairness relative to the recovery of the environmental costs which have been mandated by the EPA and the Clean Air Act, I believe strongly that we have let the people of Alabama down by not considering any formula or methodology that looks at sharing these costs between the Alabama Power Company and the consumers of Alabama. In my judgment that is wrong. My hope would be, that in considering our mission at the Public Service Commission of bringing balance, fairness and equity between the consumers of Alabama and the utilities we regulate, that in and of itself should be enough to move you to concur with me in calling a special meeting of the Commission to reconsider this matter. Understanding that it might not, let me outline a few procedural matters which I believe merit a special meeting of the Commission:

1. The transcript from the hearing on this matter was not complete until the day before our October 5, 2004 meeting, and given the fact that we were considering a 2 Billion dollar rate increase on the people of Alabama, by any standard, this was not a reasonable amount of time to review a transcript given the magnitude of the matter before us.

2. The procedural order in this case entered by this Commission provided that the parties would submit proposed orders on or before October 18, 2004. There has been an indication that the parties waived the filing of post hearing briefs but our procedural order required the parties to file proposed orders. This procedural schedule with the last submission deadline being October 18, 2004, indicated to me and likely to the general public that this matter would not be considered and voted upon until the November, 2004 Commission meeting. Why the rush to judgment?
3. As I questioned the staff during our formal meeting, it was apparent to me that no analysis had been done whatsoever, which looked at bringing about fairness and balance in terms of who should shoulder these recovery costs.
4. Apparently there were numerous meetings, based on an activity report I received from Judge Garner the day before our October 5, 2004 meeting, which occurred regarding the merits of this filing without the presence of the Attorney General or his representative. As a matter of fact, it is my understanding that the Attorney General's office was not even notified of these meetings. As you know, the Attorney General's office represents the consumers of Alabama and they should be invited to attend each and every meeting that this Commission has relative to these matters. What we do affects the consumers of this state and the people of Alabama, and the Attorney General's office is charged with the responsibility to protect the consumers of Alabama.
5. After reviewing the tape of the meeting, it appears to me that the motion which Commissioner Cook made and the synopsis of her motion by Steve Spencer and Commissioner Sullivan varied in the wording. In addition, relative to this motion, there was no evidence at the hearing concerning it. I had no time to review this motion to assess it or analyze it, nor did members of the Commission staff. As a member of this Commission I have every right to do so.
6. Because of what I consider a flaw in our public notification process, the people of Alabama had no notice relative to this matter, no knowledge of the magnitude of this filing, and thus no opportunity to be heard. In my judgment, the people of Alabama were deprived of voicing their opinion and concerns before the Commission concerning this matter. That in and of itself is not in the public interest.

GCWjr:KLR
c: Judge John A. Garner

ATTACHMENT B

Chronology of PSC Staff's Review Activities Pertaining to APCo's Environmental Concept October 4, 2004

- August 4, 2003 – Staff visited Plant Gorgas to observe and discuss the Low NOx Burners and the newly installed SCR.
- October 10, 2003 – Staff met with APCo to discuss “Air Issues Facing Alabama Power” in Birmingham, AL.
- November 13-14, 2003 – Staff visited Barry Steam Plant to observe and discuss the pre-packaged SCRs contained with the newly installed Barry CCs.
- April 6, 2004 – Met with APCo to discuss: 1) Environmental Issues Facing APCo, 2) Environmental Projects, 3) Environmental Cost Recovery, and 4) Environmental Expenditures.
- April 14, 2004 – Staff attended environmental meeting.
- April 14, 2004 – DC Commissioner Rick Morgan provided a new report entitled “Benchmarking Air Pollution from Top 100 Electric Companies” to NARUC’s ERE members (Ms. Hamilton). The report is forwarded to the staff for review.
- April 16, 2004 – Staff e-mailed Vivian Davis with NRRI to determine if NRRI has any information on Environmental Compliance Cost Recovery mechanisms.
- April 19, 2004 – Staff attended environmental meeting. Discussed concepts with APCo. Presentations given by Willard Bowers and Jerry Stewart.
- April 22, 2004 – Staff discussed operations and a possible visit to see scrubbers and SCRs installed on TVA’s Widows Creek and Cumberland Steam Plants with a plant engineer.
- April 28, 2004 – Staff met with ADEM personnel (Jeff Kitchens) to discuss environmental issue. Staff talked with other ADEM personnel (Tracy Peace, Lisa Cole) on other occasions.
- April 29, 2004 – Staff met with APCo personnel to discuss customer impacts, deferred taxes/cost of capital, prior environmental costs, other recovery options, pollution control bonds, accounting for the sell of emission allowances, sell of byproducts, fines and penalties, smoothing of customer impacts, cost of ammonia, reporting, construction budgets, legislative updates, two year outlook of all potential rate increases.
- May 4, 2004 – Staff reviewed environmental data.
- May 4, 2004 – Staff held discussions with Zeke Smith about the overall concept of the environmental cost recovery plan.
- May 5, 2004 – Staff visited Plant E.C. Gaston to meet with Dr. Larry S. Monroe to observe and discuss the “Baghouse” control technology for Mercury emissions and Electrostatic Precipitators (ESP).
- May 6, 2004 – Staff researched the appropriate use of deferred taxes as a capital source in the WCOC calculation. In addition, the staff researched the Rate CNP historical files for any information on the use of allocation methods.
- May 10, 2004 – Staff reviewed trend of environmental expenses.
- May 11, 2004 – Staff made a request of APCo personnel to discuss environmental projections.
- May 14, 2004 – Staff met to discuss environmental concept and related issues such as allocation method, procedural issues, need for certificating, need for hearing, environmental as a separate clause, WCOC w/out deferred taxes, reporting, construction process, fuel review, Rate CNP review, etc.

- May 17, 2004 – Staff conducted a conference call with Zeke Smith, Richard Hutto, Jeff Franklin, John Huggins, and Sammy Burnett to discuss the role of SCS, the scrubber program, the construction process, etc.
- May 20, 2004 – Staff met with Commissioner Sullivan to discuss environmental concept.
- May 24, 2004 – Staff met to discuss environmental issues.
- May 25, 2004 – Staff attended the “ADEM – Air Regulatory Update”.
- June 2, 2004 – Staff met to discuss environmental issue.
- June 9, 2004 – Staff visited Plant Lowman in Leroy, AL to meet with AEC personnel to observe and discuss ESP and Flue Gas Desulfurization (FGD) system technologies.
- June 21, 2004 – Staff visited Miller Steam Plant to physically inspect the scrubber retrofitting to the plant.
- June 23, 2004 – Staff met to discuss environmental issues.
- June 24, 2004 – Staff met to discuss environmental issues.
- June 25, 2004 – Staff met with Olivia Martin, Attorney General’s office, to discuss environmental issues.
- July 9, 2004 – Staff attended a meeting with Comm. Sullivan in his office.
- July 10, 2004 – Staff met with Comm. Wallace’s staff to assist with an understanding of the prior day’s meeting with Comm. Sullivan regarding the environmental issue.
- July 11-12, 2004 – Staff listened to presentations on federal Clear Skies and Clean Air proposals in NARUC’s ERE subcommittee meetings.
- July 12, 2004 – Staff visited Plant Yates in Newnan, GA to observe and discuss “Scrubber Technology”.
- July 19, 2004 – Staff met in Comm. Sullivan’s office to discuss environmental issues.
- July 28-30, 2004 – Staff attended an Environmental Seminar.
- July 30, 2004 – Staff met with Commissioner Sullivan to discuss company environmental compliance plans and procedural issues. Commissioner Sullivan requested additional information from the staff regarding cost/benefits analyses, timeline and costs of APCo environmental upgrades to-date and information regarding TVA facilities.
- August 2-4, 2004 – Staff reviewed Company’s filing to modify Rate CNP.
- August 3, 2004 – Staff reviewed procedural schedule from Legal Division.
- August 4, 2004 – Legal Division noticed the procedural schedule.
- August 4, 2004 – Staff prepared an environmental cost update for Comm. Sullivan.
- August 10, 2004 – Staff reviewed article by Fitch Ratings.
- August 9-17, 2004 – Staff prepared a report for Comm. Wallace.
- August 11, 2004 – Staff met to discuss environmental issues.
- August 11, 2004 – Staff prepared and circulated request to suspend APCo’s environmental filing.
- August 18, 2004 – Commission issued Order suspending environmental filing.
- August 20, 2004 – Staff reviewed Petition to Intervene by AG’s Office and by AIEC.
- August 19, 2004 – Staff conducted a conference call with Zeke Smith and Ken Jenkins to discuss various coal issues.
- August 23-27, 2004 – Staff reviewed APCo’s Petition.
- September 20, 2004 – Staff issued formal data request to Alabama Power Company and interveners.
- September 27-28, 2004 – Alabama Power Company responded to data request. Staff reviewed data responses.
- September 28, 2004 – Staff attended hearing on environmental petition.

- September 28-29, 2004 – Staff prepared a report for Comm. Wallace.
- September 28, 2004 – Staff attended meeting in Comm. Sullivan’s office regarding the environmental issue.

Other Review Activities

- Staff conducted a conference call with Anthony Moreno of APCo to discuss environmental laws and permitting processes.
- Staff met with APCo accounting, budgeting, and environmental personnel to discuss available accounting reports to monitor environmental projects, capital budgeting processes, and technology selection methods.
- Staff reviewed several technology related papers and reports.
- Staff reviewed several “Environmental” news articles.
- Staff reviewed several “Environmental” papers and reports published by NARUC, EPA, etc.
- Staff reviewed the use of Securitization as a financing option.
- Staff reviewed the kWh allocation method versus the revenue based allocation method.
- Staff reviewed Environmental Regulations such as: The Clean Air Act, Clear Skies, NOx SIP Call, Interstate Air Quality Rule, 8-hour Ozone Rule, One-Hour Ozone Rule, Mercury Rule, etc.
- Staff reviewed Alabama Power Company v. Southern Pine Electric Cooperative regarding the issuance of a Certificate of Public Convenience and Necessity.
- Staff reviewed capital budgeting as part of overall Corporate Goals for Performance Pay Plan.
- Staff reviewed APCo’s internal processes for determining compliance remedies.
- Staff met with Comm. Wallace to provide a brief overview of the environmental concept.
- Staff met with a representative from Comm. Wallace’s office, at the request of Comm. Wallace, to provide an overview of the environmental concept.
- Staff communicated with a representative from Comm. Sullivan’s office on at least three occasions regarding the environmental issue.
- Staff communicated with a representative from Comm. Cook’s office to provide an overview of the environmental concept.
- Staff conducted hours of research on various environmental topics.
- Staff conducted and documented a review of environmental cost recovery methods used by other State Commissions.
- Staff researched other States for reporting requirements and developed an “Environmental Compliance Plan” concept.
- Staff reviewed other States for ideas on language to be used in an Environmental Cost Recovery rate.
- Staff reviewed RRA Final Rate Case Summaries for “environmental” matters.